IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1979

NO. 79-115

POLISHING MACHINE SYSTEMS, INC.,

JOHN A. TRICOLI, JR.

HELEN TRICOLI, and

NICHOLAS DANIELS,

Petitioners

v.

RICHARD E. COFFIN,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

W.H.C. Venable
Michael S. Shelton
COHEN, ABELOFF & STAPLES, P.C.
207 West Franklin Street
Richmond, Virginia 23220

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TABLE OF CASES

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JURISDICTION

The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1254 (1). The judgment of the Court of Appeals was entered on April 25, 1979.

QUESTIONS PRESENTED

The question presented is whether the sale of an interest in a corporation by means of the transfer of stock certificates with a concomitant right and obligation to participate in the management of the corporation is a sale of "securities" within the purview of the Securities Act of 1933 and the Securities Exchange Act of 1934.

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STATUTORY PROVISIONS INVOLVED

This case involves the definition of the term "security" as set forth in the Securities Act of 1933 and the Securities Exchange Act of 1934. The Securities Act of 1933, 15 U.S.C. § 77b(l) (1971) provides as follows:

> The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security" or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Similar provisions are found in the Securities Exchange Act of 1934, 15 U.S.C. §78c(10) (1971) which provides as follows:

> The term "security" means any note, stock, treasury stock, bond debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security", or any certificate of interest or participation in,

temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

STATEMENT OF THE CASE

This is a civil action brought by Richard E. Coffin ("Respondent"), in the United States District Court for the Eastern District of Virginia, Richmond District, to recover compensatory and punitive damages for misrepresentations allegedly made to him in connection with his purchase of stock in Polishing Machine Systems, Inc. The district court dismissed the action for lack of federal jurisdiction and for failure to state a claim upon which relief can be granted. The action was dismissed upon motion made by the petitioners pursuant to Rule 12(b) (1); (b) (6) of the Federal Rules of Civil Procedure. The United States Court of Appeals for the Fourth Circuit reversed and remanded in an option entered on April 25, 1979.

STATEMENT OF MATERIAL FACTS

The claim of the respondent was dismissed by the district court

upon motion which accepted as true the allegations set forth in the complaint. These allegations show that the respondent was induced to purchase a 50% interest in the common stock of Polishing Machine Systems, Inc. for the sum of $30,000.00. Under the agreement which effected the transaction, the respondent was to share on an equal basis in the overall operation of Polishing Machine Systems, Inc., devoting his full time to duties as executive vice president of the corporation. As alleged in the complaint, Mr. Coffin became "an active participant in the business and affairs of Polishing Machine Systems, Inc. as required by the Agreement." Complaint, ¶12.

After subsequently gaining access to the corporation's books, Mr. Coffin learned that certain representations alleged to have been made to him during the negotations were materially false and misleading. Specifically, the allegations provide that Mr. Coffin discovered that Tricoli had converted corporate assets to his own use and left Polishing Machine insolvent. Mr. Coffin then brought this action in the district court to recover damages under the federal securities acts, the Virginia blue sky statute, and the common law of fraud.

RULINGS BELOW

In an Order entered July 28, 1977, the district court granted the petitioners' motion to dismiss for lack of jurisdiction pursuant to Fed. R. Civ. P. 12(b) (1) and for failure to state a claim upon which relief can be granted pursuant to Fed. R. Civ. P. 12(b) (6).

In a Memorandum Opinion filed the same day, the district court ruled that no federal question existed under the securities laws because the investment made by Mr. Coffin was not a "security" as defined by decisions of the United States Supreme Court. The district court noted that "the law must look to the substance and not the form" of a transaction involving stock. Following the rulings of this Court in Securities & Exchange Commission v. Howey Co., 328 U.S. 293 (1946) and United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975), the district court concluded that even though the form of the transaction utilized stock which had all of the attributes of ordinary stock, the substance of the transaction was not the sale of securities but the sale of a one-half interest in an ongoing business for which the purchaser was not to be an investor but rather an

active and significant participant. Noting that Mr. Coffin purchased a full one-half interest in the business, agreed to work and devote his full time and effort to its affairs, served as an officer, and shared on an equal basis in the management of the company, the district court found that Mr. Coffin was not induced to invest money in the hope of deriving a profit from the work of others and hence the transaction did not involve the sale of a security.

The United States Court of Appeals for the Fourth Circuit reversed the district court's decision and remanded the case for further proceedings in an opinion entered April 25, 1979. The circuit court found that when a transaction involves stock, there is a strong presumption that the securities statutes apply. The court stated that the question of whether an investor will derive his profit partly from his own efforts is to be considered only when there is some showing that ordinary corporate stocks are other than what they appear to be, such as interests not easily recognized as securities in the capital market. Because the alleged transferred interest involved ordinary corporate stock, the court of appeals concluded no other inquiry was necessary

or permissible under the federal securities acts. Therefor, the district court's decision was reversed and the case was remanded.

ARGUMENT IN SUPPORT OF GRANTING THE WRIT

The decision of the United States Court of Appeals for the Fourth Circuit in holding that the transaction in dispute is within the purview of the Securities Act of 1933 and the Securities Exchange Act of 1934, is a federal question decision made in a way probably in conflict with applicable decisions of the United States Supreme Court.

In holding that the transaction in question involved a security, the circuit court ignored the definitions for a security set forth in two decisions of this Court, namely, Securities and Exchange Commission v. Howey Co., 328 U.S. 293 (1946) and United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975). Rather than apply the flexible approach enunciated by this Court in Forman, the circuit court utilized the wooden approach advanced by the respondent.

Mr. Coffin initially argued before both the district and

circuit courts that because the literal definition of "security" includes "any .... stock" and because the stock sold to Mr. Coffin has "all the characteristics one usually associates with stock", that the transaction set forth in the complaint clearly fell within the purview of the federal legislation. This argument runs contrary to the rationale of Forman as well as numerous decisions from other circuits.

In United Housing Foundation, Inc. v. Forman, supra, the plaintiffs purchased shares of stock in a housing co-op as prerequisites to becoming tenants in the project. When certain false and misleading representations were discovered in the information bulletin used to attract the tenants, the tenants sought relief from the federal courts under the same securities acts relied upon by Mr. Coffin. This Court quickly rejected the argument that a stock is a stock is a stock. A transaction is not to be considered a security transaction under the protection of the federal securities acts simply because the transaction is evidenced by the sale of shares called "stock" even though the statutory definition of security includes the words "any ... stock." 421 U.S. at 848. Instead, in searching for the meaning and scope of the word "security," a court must disregard the form of the trans-

action and look to its substance.

The same principle was applied to a converse situation in Securities & Exch. Com. v. Howey, Co., supra. In Howey, the Securities and Exchange Commission sought to halt the offering of units in a citrus development. Although the transaction did not fall within the literal definition of a "security," this Court disregarded the name given to the transaction but looked to its substance.

Contrary to the circuit court's ruling, therefore, the mere fact that the transaction set forth in Mr. Coffin's complaint involved the transfer of shares of the corporation's stock does not per se bring the transaction within the purview of the federal acts. Mr. Coffin must demonstrate that the substance of the transaction, and not its form, constitutes a sale of securities.

The district court carefully considered the allegations in Mr. Coffin's complaint, the agreement between the parties dated February 15, 1976 and the descriptive report prepared by the defendants and determined that the substance of the transaction alleged in the complaint removed it from the purview of the federal legislation. To determine the appropriate standard

by which the substance of the transaction was to be measured, the district court again looked to the decisions in Forman and and Howey.

In Howey, the respondents owned large tracts of citrus acreage which were planted annually. Approximately one-half of the acreage was kept by the respondents and the other half was offered to the public. Each purchaser was offered a land sales contract and a service contract for the harvesting and marketing of the crops. Looking to the substance of the transaction to determine whether it was within the protection of the federal securities acts, this Court stated: "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." 328 U.S. at 301. In finding that the transaction in Howey came within the spirit if not the letter of the federal acts, this Court noted that the purchasers had no desire to occupy the land or to develop it themselves. The purchasers were attracted solely by the prospects of a return on their investment not a return on their own efforts. The purchasers were to provide the capital and share in the earnings and profits;

the promoters were to manage, control and operate the enterprise.

The same test was applied by this Court in Forman. Quoting from its earlier opinion in Howey, this Court expanded the application of the Howey test to situations other than investments contracts.

> We perceive no distinction, for present purposes, between an "investment contract" and an "instrument commonly known as a ‚security'." In either case, the basic test for distinguishing the transaction from the other commercial dealings is
>
> > "whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." [citation omitted]
>
> The test, in shorthand form, embodies the essential attributes that run through all of the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. 421 U.S. at 852.

In Forman, this Court found that the purchasers were attracted solely by the prospect of acquiring a place to live, and not by financial returns on their investment. The opinion noted:

> What distinguishes a security transaction - and what is absent [in the situation of Forman] is an investment where one parts with his money in the hope of receiving profits from the efforts of others,

> and not where he purchases a commodity for personal consumption or ... for personal use 421 U.S. at 858.

The key factor in both Howey and Forman was whether the purchaser could be fairly characterized as an "investor," attracted by the prospects of a return on his investment of money and looking to derive profits from the efforts of others or whether the purchaser could be fairly characterized as a "participant," attracted by the prospects of a return on the investment of his time and effort and looking to derive profits from his own efforts. Accord. Emisco Industries, Inc. v. Pro's Inc., 543 F.2d 38 (7th Cir. 1976). This Court has re-iterated on numerous occasions that the purpose of the securities acts is to protect the interest of investors. 421 U.S. at 850 (emphasis added). In judging situations as presented in Howey, Forman and the instant case, courts must look at the economic realities to determine whether the purchaser is to be an "investor" or "participant."

Applying this well-defined test to the facts in the instant case, the district court easily determined that Mr. Coffin was not a mere investor. Judge Warriner found that Mr. Coffin was not really buying shares of stock; he was buying a half interest in an ongoing

business with a concurrent right and obligation to participate in its management as an equal partner. Mem. op. at 3. The Court reviewed extensively the agreement between the parties dated February 15, 1976 which provided that Mr. Coffin was to "share on an equal basis in the overall operation of Polishing Machine Systems, Inc.," was to assume a position as officer of the corporation and was to "use [his] best efforts and full time in the day to day overall management of the company." Mr. Coffin in his complaint, concedes that the substance of the transaction was a 50-50 partnership; he was "to become an active participant in the business and affairs of PMS, as required by the Agreement." In fact, Mr. Coffin assumed the duties of executive vice president of PMS in May of 1976. From these facts, the district court concluded that the transaction set forth by Mr. Coffin did not come within the securities acts. The plaintiff was not seeking a profit or return solely from the "entrepreneurial or managerial efforts of others." Instead, he bought himself a job with the company and assumed an official position as executive vice president with 50-50 managerial right. Mem. op. at 6.

An analysis similar to that being urged by the respondents has been employed by various circuits in interpreting the term "note" as contained in the securities acts. See e.g., Emisco Industries Inc. v. Pro's Inc., 543 F.2d 38 (7th Cir. 1976). See also Romney v. Richard Prows, Inc., 289 F. Supp 313 (d. Utah 1968); Polikoff v. Levy, 55 Ill, App. 2d 229, 204 N.D. 2d 807, cert. denied, 382 U.S. 903 (1965). Applying the test enuniciated by this Court in Howey, these courts have looked to the substance of each transaction rather than merely accept at face value that the instrument employed in the transaction comes within the literal coverage under the securities acts. Clearly, the Howey standard has been expanded beyond merely "investment contracts" and should be employed in this instance as was done by the district court.

CONCLUSION

The failure of the circuit court to apply the Howey test in the instant case runs contrary to the prior decisions of this Court and other circuit courts and provides strong reason for the granting of the writ requested by the petitioners. The issue raised herein is of greater importance and requires further clarification by

this Court. Accordingly, the petitioner requests that this matter be given further consideration on writ of certiorari.

Respectfully submitted,

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Counsel for Petitioners

CERTIFICATE

I hereby certify that on the 24th day of July, 1979, a true and correct copy of the foregoing Petition for Writ of Certiorari was hand delivered to Stuart W. Settle, Esquire, 200 West Franklin Street, Richmond, Virginia, 23220, counsel for respondent.

Michael S. Shelton

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF VIRGINIA
RICHMOND DIVISION

RICHARD E. COFFIN	:	
	:	
v.	:	CIVIL ACTION
	:	NO: 77-0318-R
JOHN A. TRICOLI, JR., et al	:	

MEMORANDUM

This matter is before the Court on defendants' motions of 5 July 1977 pursuant to Fed. R. Civ. P. 12(b) (1), 12(b) (6) to dismiss the above-styled action for lack of jurisdiction and for failure to state a claim upon which relief can be granted. As plaintiff has filed a responsive brief to these motions and defendants have filed their rebuttal brief, the motions to dismiss are ripe.

A summary of the facts relevant to this motion as alleged in plaintiff's complaint is substantially as follows: Defendant Mr. Tricoli, president of defendant Polishing Machine Systems, Inc., (hereinafter PMS) a Virginia corporation, approached plaintiff in November 1975. Plaintiff at that time was operating a service station in New York State. Defendant induced plain-

tiff to become an "area distributor" of PMS products. The fee charged for the "distributorship" was $3,500.

A few months later defendant Mr. Tricoli, defendant Mrs. Tricoli, and defendant Mr. Daniels, attorney for defendant PMS, met with plaintiff for the purpose of inducing plaintiff to purchase for $30,000 a 50% interest in the unregistered common stock of PMS. Shortly afterward plaintiff entered into an agreement with defendant Mr. Tricoli setting forth the terms of the $30,000 stock purchase, one of which was that plaintiff, as executive vice-president, was to share on an equal basis in the overall operation of PMS. Some several months after gaining access to the books and accounts of PMS, plaintiff determined that the representations made to him had been materially false and misleading and, in fact, PMS was in a position of insolvency. Plaintiff is now suing for both compensatory and punitive damages.

It is defendants' position that the Court lacks jurisdiction in this matter as the Securities Act of 1933 and the Securities and Exchange Act of 1934 do not grant jurisdiction to federal courts unless there has been a fraudulent sale of a security

as defined by those Acts. Defendants argue that the transaction described by the plaintiff does not fall within the definition of a security and, hence, plaintiff's complaint fails both for lack of jurisdiction and for failure to state a claim upon which relief can be granted.

In support of their position, defendants cite the recent case of United Housing Foundation, Inc. v. Forman, 421 U.S.837 (1975) in which the Supreme Court held that the mere sale of shares called "stock" is not conclusively a security transaction within the coverage of the Security Acts simply because the statutory definition of a security includes the words "any... stock." Instead, in searching for the meaning and scope of the word "security" as used in the Securities Acts, courts should disregard form and look to the substance of the transaction. 421 U.S. at 849. The High Court went on to state that a security involved "the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts, of others." 421 U.S. at 853 (emphasis added).

Plaintiff argues that since what defendants sold to him

was clearly, unequivocally, completely, and without modification or limitation, shares of stock then the Act must apply without regard to any other consideration. He points out that the decision in Forman is inapposite since, though there the instrument was called "stock" the reality was that it was not stock since it lacked most or all the significant attributes of stock. By contrast, the allegations of the complaint and the undeniable fact is that in this case the investment by plaintiff is represented by shares of stock to which are attached all or substantially all the attributes generally associated with that term. The Court must determine whether plaintiffs' straightforward and direct reading of the statute is consonant with the teaching of the decided cases.

Repeatedly, the law is laid down in this area that courts are to look to substance and not to form. The substance of the transaction alleged in the complaint is that plaintiffs bought a half-interest in the business along with the right to participate 50-50 in its management. Further, they proceeded to exercise that ownership and management. The fact that the transfer of the ownership interest and the management right took the form of the sale of stock does not alter the substance.

Nor does it alter the fact that though the form of the sale was through stock the investment was not made for the purpose of seeking a profit or return solely through the work of others. The offer of the sale of the stock was contained in language to the effect that defendant Mr. Tricoli does, "hereby offer unto Richard E. Coffin a 1/2 (one-half) interest of Polishing Machines Systems, Inc. That is a full 50-50 agreement. The purchase price for said interest, the sum of $30,000."

The contract goes on to say that, "[u]pon acceptance of this agreement, Mr. Coffin is to share on an equal basis in the over-all operation of Polishing Machine Systems, Inc.. and all other directly related and wholly owned subsidiaries."

Paragraph six of the agreement provided "Tricoli and Coffin will at all times use their best efforts and full time in the day to day overall management of the company, following through with agreed company plans, policy and standard operation.

Paragraph seven provided for plaintiffs and Mrs. Coffin to assume positions as officers of the corporation and, finally, in paragraph ten the question of the issue of stock is dealt with.

It reads as follows, "Upon acceptance of this agreement, the shares representing this 50-50 agreement to be immediately issued."

The substance of the investment made by plaintiff is as set forth in the agreement from which the excerpts above are taken. Since the business was a corporation, the form of the purchase of the one-half interest and the assumption of one-half management rights was through the sale of stock. The law must look to the substance and not to the form. The question, then, is where the substance of a business transaction is the sale of an interest in a corporation with a concomitant right and obligation to participate in the management, are the certificates of stock issued to represent the transfer of that ownership interest "stock" within the meaning of Section 2(1) of the Securities Act of 1933?

That the name given to the investment instrument is not to be given a wooden meaning is made clear by Securities & Exch. Com. v. Howey Co., 328 U.S. 293 (1946). Howey discusses and defines an "investment contract" within the meaning of Section 2(1) of the Securities Act of 1933. On pages 297-299, in

discussing the meaning, the Court points out that at common law "an investment contract...came to mean a contract or scheme for 'the placing of capital or laying out of money in a way intended to secure income or profit from its employment.' " Omitting citations, the Court went on to say:

> This definition was uniformly applied by State courts to a variety of situations where individuals were led to invest money in a common enterprise with the expectation that they would earn a profit solely through the efforts of the promoter or of someone other than themselves. [328 U.S. at 298 (emphasis added)].

The Court defined an investment contract for purposes of the Security Act as meaning:

> [A] contract, transaction or scheme whereby a person invests his money in a common enterprize and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise. [328 U.S. at 298, 299.]

The Supreme Court observed that this definition:

> [P] ermits the fulfillment of the statutory purpose of compelling full and fair disclosure relative to the issuance of 'the many types of instruments that in our commercial world fall within the ordinary concept of a security.... It embodies a flexible rather than a static principle, one that is capable of adaptation to

> meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.' [328 U.S. at 299 (emphasis added)].

Finally, the Supreme Court observes that:

> [T]he test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others. If that test be satisfied, it is immaterial whether the enterprise is speculative or nonspeculative or whether there is a sale of property with or without intrinsic value. [328 U.S. at 301].

Though the Supreme Court in Howey consistently used the term "investment contract" it is clear that the definition used is applicable to "a variety of situations," "whether...evidenced by formal certificates or by nominal interest," for "many types of instruments," effectuating "countless and variable schemes." Thus, this Court is constrained to apply the definition to all securities, all devices and schemes, all forms or manners in which one may be induced to invest money in the hope of deriving a profit from the work of others. Even though the security be clearly, unequivocally and without quibble a share of stock nevertheless, if it does not represent an interest in an enterprise from which the investor seeks to derive a profit solely from the work of others then it is not "stock" for purposes of the Act no matter

what its efficacy as stock for other purposes may be.

The premise that in Howey the Supreme Court was not defining the narrow concept of an "investment contract" but was instead trying to define the "countless and variable schemes devised by those who seek the use of money of others on the promise of profits" is made clear by its further discussion in Forman, supra. The Court held in Forman that the mere naming of a piece of paper as "stock" did not make it stock for the purposes of the Act. 421 U.S. at 848. This distinction was emphasized when the Court said that previous decisions had:

> [M]ade clear that [the Court] was not establishing an inflexible rule barring inquiry into the economic realities underlying a transaction. On the contrary, the Court intended only to make the rather obvious point that, in contrast to the instrument before it which was not included within the explicit statutory terms, most instruments bearing these traditional titles are likely to be covered by the statutes. In holding that the name given to an instrument is not dispositive, we do not suggest that the name is wholly irrelevant to the decision whether it is a security. There may be occasions when the use of a traditional name such as "stocks" or "bonds" will lead a purchaser justifiably to assume that the federal securities laws apply. This would clearly be the case when the underlying transaction embodies some of

> the significant characteristics typically associated with the named instrument.. 421 U.S. at 850-851

In further support of the view that a device, no matter what its name, must meet the definition of "an investment of money in a common enterprise with profits to come solely from the efforts of others," the Court in Forman said "we perceive no distinction, for present purposes, between an 'investment contract' and an 'instrument commonly known as a security.'" 421 U.S. at 852. The Court goes on to say:

> This test, in shorthand form, embodies the essential attributes that run through all the Court's decisions defining a security. The touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.... In such cases the investor is 'attracted solely by the prospects of a return' on his investment .... By contrast, when a purchaser is motivated by a desire to use or consume the item purchased - 'to occupy the land or to develop it themselves,' as the Howey court put it, ibid. - the securities laws do not apply. [421 U.S. at 852-853]. (emphasis added).

By that definition and that discussion it is clear that the investment made by the plaintiff in this case does not come under the Act. He was not seeking a profit or return solely

from the "entrepreneurial or managerial efforts of others." Instead, he bought himself a job with the company and assumed an official position as executive vice-president with a 50-50 managerial right. To use the phrase of the Supreme Court in Forman, "the securities laws do not apply."

Plaintiff points out that even though Howey stressed the language "solely the work of others," the Ninth Circuit Court of Appeals in S.E.C. v. Glen W. Turner, Inc., 474 F. 2d 476 (9th Cir. 1973) refused to bar the plaintiffs from their Securities Act claim merely because they had to exert substantial effort of their own to obtain a profit. The Court held that the word "solely" should not be applied mechanistically so that any effort or work by the investor, no matter how slight, would remove the investment from the coverage of the Act. The Ninth Circuit adopted what is considered a more realistic test: "Whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise." 474 F.2d at 482.

This test may not be as easy to apply as it is to formulate. In most business enterprises the managerial efforts of several persons,

as a practical matter, "affect the failure or success of the enterprise." An investor who also becomes a part of management should not be able to claim the protection of the Act merely because others in the common enterprise exert essential managerial efforts which affect the failure or success of the enterprise. If the investor-manager participates in those managerial efforts then even the Turner gloss on the word "solely" would not bring the investment within the coverage of the Act.

Indeed, the facts in Turner show that the investor there had no management duties at all. Each investor was a promotor of his own pyramid empire but the money he invested was in a corporation controlled wholly by others. A Chevrolet dealer who buys stock in General Motors would not be precluded from protection of the Act merely because his efforts (indeed managerial efforts) affect the failure or success of General Motors.[1] But one who purchases a one-half interest in a corporation, who devotes his full time and effort to its corporate affairs, who assumes and accepts the position of executive vice-president and who serves in that capacity for a substantial period of time cannot be said

to be depending "solely" on the efforts of others to realize on his investment.

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1. The word "affect" has no life or death connotations. Every sale of a Chevrolet (or failure to sell) affects the success (or failure) of General Motors.

In the absence of federal question jurisdiction under the securities laws the pendent jurisdiction over the remaining counts of the complaint falls. It is appropriate, however, to paraphrase the Supreme Court in part three of its Forman decision:

> In holding that there is no federal jurisdiction, we do not address the merits of [plaintiff's] allegations of fraud. Nor do we indicate any view as to whether the type of claims here involved should be protected by federal regulation. We decide only that the type of transaction before us, in which the purchasers [assumed a substantial and significant managerial position in the enterprise], is not within the scope of the federal securities laws. [421 U.S. at 859-860].

Accordingly, the complaint will be dismissed.

An appropriate order shall issue.

United States District Judge

Date: 28 July 1977

PUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

NO. 77-2360

Richard E. Coffin,

Appellant,

v.

Polishing Machines, Inc.
John A. Tricoli, Jr., Helen Tricoli,
and Nicholas Daniels,

Appellees.

Appeal from the United States District Court for the Eastern District of Virginia, at Richmond. D. Dortch Warriner, District Judge.

Argued: February 6, 1979 Decided: April 25, 1979

Before HAYNSWORTH, Chief Judge, BUTZNER and WIDENER, Circuit Judges.

Stuart W. Settle (John C. Moore, Coates, Comess, Settle, Moore & Taylor on brief) for Appellant; Michael S. Shelton (W.H.C. Venable, Cohen, Abeloff & Staples, P.C. on brief) for Appellees.

BUTZNER, Circuit Judge:

Richard E. Coffin sued in the district court to recover compensatory and punitive damages for misrepresentations allegedly made to him in connection with his purchase of stock in Polishing Machines Systems, Inc. The district court dismissed the action for lack of federal jurisdiction and for failure to state a claim upon which relief could be granted. We reverse and remand..

I

Coffin's complaint alleges the following facts. Polishing Machines is a Virginia corporation that sells commercial car waxing and polishing equipment. John Tricoli, president of the company, visited Coffin's New York service station late in 1975 in order to interest Coffin in the company's products. As a result of the visit, Coffin became an area distributor for the company. Tricoli then gave Coffin a copy of a report describing the company and encouraged him to consider purchasing stock that the company wanted to sell in order to finance expansion. After negotiations in Virginia and New York, the parties reached an agreement. Their written contract provided that Coffin would

buy half of the outstanding shares in Polishing Machines, sell his service station, move to Virginia, and devote his full time to duties as executive vice president of the corporation. Pursuant to the contract, Coffin sold his business and began work at Polishing Machines in May, 1976. The stock that he purchased had all of the attributes of ordinary common stock.

After gaining access to the company's books, Coffin learned that representations made to him in the report and during the negotiations were materially fals and misleading . Specifically, he discovered that Tricoli had converted corporate assets to his own use and left Polishing Machines insolvent. Coffin then brought this action in the district court to recover damages under the federal securities acts, the Virginia blue sky statute, and the common law of fraud.

The district court granted motions under Federal Rule of Civil Procedure 12 (b) (1) and (b) (6), dismissing the case on its pleadings. The court relied on United Housing Foundation, Inc. v. Forman, 421 U.S. 837 (1975), for the proposition that not every sale of stock falls within the coverage of the federal securities statutes. It then reasoned that even ordinary corporate stocks are not securities within the meaning of the federal statutes unless they "represent an interest

in an enterprise from which the investor seeks to derive a profit solely from the work of others . . . ." See SEC v. Howey Co., 328 U.S. 293, 298 (1946). Since Coffin wastto contribute substantially to the management of Polishing Machines, the court held that the substance of the transaction in this case was the sale of a half interest in a business even though the transfer took the form of a sale of stock.

II

We do not believe that Forman denies a purchaser of ordinary corporate stock the protection of the federal securities laws simply because he intends to participate in the management of the corporation in which he invests. Both the Securities Act of 1933, 15 U.S.C. § 77b(1), and the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10), include "stock" within their definitions of a "security." Thus, when a transaction involves stock, there is a strong presumption that the statutes apply. Occidental Life Insurance Co. v. Pat Ryan & Associates, Inc., 496 F.2d 1255, 1261 (4th Cir. 1974). Forman requires us to analyze the substance of a transaction only when the stocks involved do not have the "significant characteristics typically associated with the named

instrument." See Forman, 421 U.S. 837, 850-51.

Absent some showing that ordinary corporate stocks are other than what they appear to be, we need not consider whether an investor will derive his profit partly from his own efforts. That test, drawn from SEC v. Howey Co., 328 U.S. 293, 298 (1946), applies to interests not easily recognized as securities in the capital market. It does not apply to stock that comes within the clear language of the securities acts. The court in Forman, for example, applied the Howey test only after deciding that the shares under consideration were not like ordinary capital stock. See Forman, 421 U.S. 837, 850-53; Bronstein v. Bronstein, 407 F. Supp. 925, 929-30 (E.D. Pa. 1976).

When ordinary corporate stock is involved in a transaction, we likewise need not consider whether the parties could have structured their arrangement in some other form. The parties in this case chose to implement their plan for joint ownership by means of a stock transfer rather than a partnership agreement or a sale of assets. Having decided to deal in stock, they brought their transaction under the provisions of the federal securities statutes. Occidental Life Insurance Co. v. Pat Ryan & Associates, Inc., 496 F2d 1255, 1263 (4th Cir. 1974). Indeed, the descriptive report supplied to Coffin during the negotiations